US Economic Perspectives

September FOMC Minutes: Hawkishness to remain high through Q4

Economics

Americas

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Reductions in asset purchases to be made each month starting with a $15bn cut

As we expected, the September FOMC Minutes delivered strong signals on the specifics for implementation of the Fed's balance sheet taper. The Minutes showed that the Committee has coalesced around a monthly reduction in the pace of asset purchases by $15 billion per month. Consistent with Chair Powell's comment at the press conference, the Minutes also showed broad agreement for ending the purchases altogether in mid-2022. We expect that at the November meeting, the FOMC will announce that, starting in mid-November, the pace of monthly asset purchases will come down by $15 billion ($10 billion of Treasury securities and $5 billion of MBS). These reductions will continue each month such that in mid-June, the purchase pace will go to zero. This schedule is roughly in line with what the Committee discussed in September per the Minutes. We estimate that this implies that the duration that the private sector absorbs next year will decline by 14% (21% under our previous expectation). Our updated monthly issuance projections are available in this link.

High bar for a change in pace

The Minutes also said that the Committee could adjust the pace of moderation of purchases if economic developments were to differ substantially from expectations. Notably, no mention was made of the pace of the taper being dependent on the health outlook. In our view this implies a high bar for a slowdown of the taper. In addition, we think it is unlikely that the FOMC would accelerate the pace. We expect that if inflation surprises the Committee to the upside such that they thought it would be important to tighten financial conditions, they would likely do this via more hikes in the dot plot.

Medians in December dot plot likely to move higher

The Minutes showed that there is still a sizable group that is concerned about the inflation outlook. In particular, "many" participants noted the substantial rise in some survey-based measures of inflation expectations. Given these concerns, the sharp downward move in the unemployment rate in September, and our view that inflation will surprise the Fed to the upside during the remaining part of the year, we expect that the dot plot in December will show a more hawkish distribution than in September. We think that the median dot will show a full hike in 2022 (it showed half a hike in September) and 4 cumulative hikes through 2023 (it showed 3.5 cumulative hikes in September).

Board staff turns slightly more dovish on inflation

The Board staff revised upward its 2021 projection of inflation. It also characterized 2022 inflation in a way similar to July, i.e. "a little below 2 percent." Our view of this is that their expectation of 2022 inflation is around 1.7-1.8%, which is well below the FOMC's median forecast of 2.3% for Core PCE. Notably, the staff now expects inflation to reach 2% only in 2024 (previously in 2023).

Active debate on participation rate

The Minutes showed that there is an active debate within the FOMC on the outlook for the participation rate. "Various" participants think that a return to pre-pandemic levels is unlikely. Also, "a number of others" argue that participation could return to, or even exceed, these levels. We think that this debate is one of the drivers behind a divided view on potential 2022 hikes. We expect that the participation rate will rise materially in 2022, loosening the labor market, and giving more arguments to the doves who want to hold off on hikes.